QUARTERLY REPORT

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Carmignac P. Flexible Bond: Letter from the Fund Managers

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-0.05%

Carmignac P. Flexible Bond's performance

in the 2nd quarter of 2023 for the A EUR Share class

+0.20%

Reference indicator's performance

in the 2nd quarter of 2023 for ICE BofA ML Euro Broad index (EUR)

-0.25%

Relative performance of the Fund

over the quarter versus its reference indicator

Carmignac Portfolio Flexible Bond *shed -0.05% (class A shares) in the second quarter of 2023, slightly underperforming its reference indicator (ICE BofA ML Euro Broad Index (EUR)), which added 0.20%.*

The bond markets today

The second quarter was marked by a challenging market climate for fixed income as yield curves flattened to a considerable extent. While short-term rates had outperformed substantially at the end of Q1 on the back of renewed banking risk, that trend reversed in Q2. This was especially true in the US, where the Federal Reserve was forced to maintain its hawkish tone in the face of resilient consumer spending and a still-overheating job market. US inflation eased further in Q2, coming in at 4% year-over-year in June, and the Fed lifted its full-year forecasts for GDP growth (from 0.4% to 1%) and inflation (from 3.6% to 3.9%). Even though investors were hoping for a pause in the Fed's tightening cycle in June, the central bank's dot plot suggested two more rate hikes are on the cards between now and year-end. Notwithstanding the collapse of First Republic Bank in April, the yield on 2-year US Treasuries rose 77 bp over the quarter, lifted by the prospect of further monetary tightening. However, the yield on 10-year Treasuries added just 37 bp over a similar period.

This trend was even more pronounced in the eurozone where the yield on the 2-year German Schatz gained 51 bp, while that on the 10-year Bund edged up just 2 bp. This differential partly reflects the resilience of eurozone core inflation (i.e. inflation without food and energy prices) which was 5.4% year-over-year in June. That level of consumer price growth means the ECB must maintain its restrictive stance. What's more, Germany has tipped into a technical recession and leading economic indicators are trending downwards, provoking bearish sentiment among market participants, which is also reflected in the nearly flat 10-year Bund yield.

Q2 also saw the latest episode in the recurring US debt-ceiling saga. The government was on track to hit its debt limit in May until the Republicans and Democrats reached a bipartisan deal to raise the ceiling. Although this event triggered a spike in volatility, bond investors' risk appetite generally returned. Credit spreads narrowed: the main CDS index fell 11 bp over the quarter and the iTraxx Crossover index dropped 36 bp.

Asset allocation

We adjusted our asset allocation in Q2 in response to the changing market climate:

We gradually increased the portfolio's modified duration from 5 in early April to 7 at quarter-end, primarily through a heavy weighting on the long-dated (10-year) segment of the yield curve. We intend to maintain this positioning: now that the first signs of a slowdown in economic growth are appearing, we have greater visibility on the trajectory of fixed-income markets going forward. We also initiated a short position on Japanese rates in Q2; the
record-high core inflation levels in the country will force the new Bank of Japan governor to adopt a more hawkish tone after 25 years of monetary easing.

We plan to maintain our credit-market exposure since the current environment is favourable to carry strategies. Spreads on corporate debt still factor in a default rate that we feel is overestimated, making the prices of this debt attractive. We've therefore kept our positions on European financial debt, high-yield corporate bonds, collateralised loan obligations, and emerging-market debt.

Outlook

We have a constructive outlook on the disinflationary trajectory that various economies look set to follow between now and end-2023. Core inflation is stuck above the 2% target set by the main central banks, but the slowdowns underway in a number of countries – as observed in leading economic indicators – should enable central banks to ease up on their monetary tightening. In the near term, we believe these factors call for a healthy risk appetite in terms of both modified duration and credit exposure. Our modified duration is currently close to its upper bound, as we believe the end of the tightening cycle is at hand. Our preference goes to the intermediate and long-dated segments of the yield curve as they're less volatile and stand to gain the most from slowing economies. With regard to credit exposure, today's climate is a boon to carry strategies like those available in credit: valuations are attractive, consumer spending is holding up, and worries about US regional banks are fading.

In light of the sticky nature of core inflation, we're keeping our long positions on real interest rates and breakeven inflation rates. Central banks could very well be prompted to reconsider their inflation targets, like the ECB did in June.

Source: Carmignac, 30/06/2023.

Carmignac Portfolio Flexible Bond

A flexible solution aiming to capture bond opportunities globally

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Carmignac Portfolio Flexible Bond A EUR Acc

ISIN: LU0336084032

Recommended minimum investment horizon

Main risks of the Fund

INTEREST RATE: Interest rate risk results in a decline in the net asset value in the event of changes in interest rates.

CREDIT: Credit risk is the risk that the issuer may default.

CURRENCY: Currency risk is linked to exposure to a currency other than the Fund's valuation currency, either through direct investment or the use of forward financial instruments.

EQUITY: The Fund may be affected by stock price variations, the scale of which is dependent on external factors, stock trading volumes or market capitalization.

The Fund presents a risk of loss of capital.

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